
Formal and Informal Measures for Controlling Competition in Japan: Institutional Overview and Theoretical Evaluation

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Enacted in 1947, Japan's original Antimonopoly Law (AML) was a major component of the post-World War II economic democratization policy pursued by the Occupation Forces. Modeled after US antitrust laws, the AML was rigorously procompetitive. Not only was a per se illegal standard for cartels applied, but stringent control over mergers and acquisitions was imposed. However, as time passed, a rigorous competition policy based on the original AML came to be recognized as unrealistic, and several amendments to the AML were introduced with the purpose of relaxing major provisions of the law. As early as 1953, for example, the per se illegality of cartels was modified to a prohibition of cartels only if they restrained competition to the substantial detriment of the "public interest"; recession cartels and rationalization cartels were exempted from the AML under some conditions. Several other laws were introduced that exempted certain anticompetitive agreements among firms from the application of the AML, thereby allowing anticompetitive agreements in such areas as the export-import industry, small enterprises, marine transport, fire and marine insurance, and certain specific areas such as coal and fertilizers.

In addition to these laws and provisions, which explicitly legalized some anticompetitive practices, the Japanese government, in particular the Ministry of International Trade and Industry (MITI), sought administrative guidance as an informal means of achieving industrial policy

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objectives. MITI often gave private firms administrative guidance on forming cartels and consolidating private resources and facilities. Such administrative guidance has been applied even when no exempting provision has existed, which occasionally has ignited debates on whether cartels are unlawful even if they are based on MITI's administrative guidance.

Several other measures existed that could be invoked by the government to regulate competition, for example, laws restricting entry, stipulating various qualifications for business start-ups, and controlling prices. These laws, which included public utility regulation, licensing for maintaining health and safety standards, and protection of a specific industry such as agriculture, enabled the government to interfere directly in an industry by entry regulation, price regulation, or both.

In view of these measures for controlling competition in Japan, which not only ranged widely in coverage but were complicated in their stipulations, one naturally is led to wonder why there should be so many channels through which the free working of the competitive market mechanism could be interfered with, despite the deeply rooted consensus among orthodox economists on the welfare-enhancing effects of increased competition. The purpose of this chapter is to present a succinct overview and evaluation of the systems of exemption from the AML and other measures for controlling competition in postwar Japan.

The plan of this chapter is as follows: In section 2, it is shown that the answer to the question as to whether there is room for rationalizable government interference in the free working of the competitive market mechanism hinges on which criterion is selected from among consumers' surplus, producers' surplus, and the social welfare in terms of net market surplus. Addressing this question is helpful in gaining an understanding of the nature and scope of the different stances of MITI, the Fair Trade Commission of Japan (JFTC), the business community at large, and Japan's Supreme Court in the context of whether and to what extent competition should be regulated in the name of promoting the public interest. In section 3, a succinct summary is provided of the system of exemptions from the AML and other exempting laws. In section 4, the problem inherent in entry regulation in terms of administrative guidance is illustrated by a case study of the Large-Scale Retail Store Law and its erosion. Section 5 focuses on the telecommunications industry following the 1985 Telecommunications Reform, whereby competition has been handcuffed by the Ministry of Posts and Telecommunications even subsequent to the industry's liberalization and the Nippon Telegraph and Telephone Public Corporation's privatization by the reform. In section 6, the Antimonopoly Law Guidelines Concerning Joint Research and Development are briefly examined. Conclusions are provided in section 7.

On the Rationale of Interference in Market Competition

Socially Excessive Firm Entry under Private Incentives

To orient subsequent analysis, I begin by examining the welfare effects of firm entry, which capitalizes on Suzumura (1995, part 1).

Consider an industry where n firms are producing a single homogeneous good, where $2 \leq n < +\infty$. The inverse demand function and the cost function of each firm are $p = f(Q)$ and $c(q_i)$, respectively, where p is output price, q_i is output of firm i , and $Q = \sum_{j=1}^n q_j$ is industry output. It is assumed that firms are identical, that $f(Q)$ is twice continuously differentiable with $f'(Q) < 0$ for all $Q \geq 0$ such that $f(Q) > 0$, and that $c(q_i)$ is twice continuously differentiable with $c(q_i) > 0$, $c'(q_i) > 0$, and $c''(q_i) > 0$ for all $q \geq 0$.

Consider a game G , which is defined by a set of players $N = \{1, 2, \dots, n\}$ and a profile of payoff functions $\{p^i \mid i \in N\}$, where p^i is defined by $p^i(q_i; Q_{-i}) = q_i f(q_i + Q_{-i}) - c(q_i)$, and $Q_{-i} = Q - q_i = \sum_{j \neq i} q_j$. Let $q^N(n) = (q_1^N(n), q_2^N(n), \dots, q_n^N(n))$ be the Cournot-Nash equilibrium of game G , which is characterized by

$$f(Q^N(n)) + q_i^N(n) f'(Q^N(n)) - C'(q_i^N(n)) = 0, \quad (1)$$

where $Q^N(n) = q_i^N(n) + Q_{-i}^N(n)$. Assuming that firms are identical, we focus on the symmetric Cournot-Nash equilibrium, so that we have $q_i^N(n) = q^N(n)$, say, for all $i \in N$. Throughout this chapter, we assume that the strategic substitutability holds, that is, that $b^N(n) < 0$ is satisfied, where $b^N(n) = (\partial^2 / \partial q_i \partial q_j) p^i(q_i^N(n); Q_{-i}^N(n))$ ($i \neq j$). It is easy to verify that this assumption guarantees $(d/dn)q^N(n) < 0$ and $(d/dn)Q^N(n) > 0$. See Suzumura (1995, chapter 1).

Let $p^N(n)$ be the profits earned by each firm at $q^N(n)$; that is,

$$p^N(n) = q^N(n) f(Q^N(n)) - C(q^N(n)). \quad (2)$$

Since $p^N(n) >$ (or $<$) 0 induces new entry of potential competitors (or exit of incumbent firms), a long-run equilibrium will be attained only if the number of firms reaches the equilibrium value, n_e , which is defined by $p^N(n_e) = 0$. Let $CS^N(n)$ and $PS^N(n)$ stand for the consumers' surplus and the producers' surplus, respectively, which are defined by

$$CS^N(n) = \int_0^{Q^N(n)} f(Z) dZ - Q^N(n) f(Q^N(n)) \quad (3)$$

and

$$PS^N(n) = \sum_{i=1}^n \{q_i^N(n) f(Q^N(n)) - C(q_i^N(n))\}. \quad (4)$$

By adding up $CS^N(n)$ and $PS^N(n)$, we obtain a social welfare measure in terms of net market surplus, that is, $W^N(n) = CS^N(n) + PS^N(n)$.

To see how these criteria will be affected by an exogenous change in n , we differentiate $CS^N(n)$, $PS^N(n)$, and $W^N(n)$ with respect to n to obtain

$$(d/dn)CS^N(n) = -Q^N(n)f'(Q^N(n))(d/dn)Q^N(n), \quad (5)$$

$$(d/dn)PS^N(n) = p^N(n) + Q^N(n)f'(Q^N(n))\{(d/dn)Q^N(n) - (d/dn)q^N(n)\} \quad (6)$$

and

$$(d/dn)W^N(n) = p^N(n) - Q^N(n)f'(Q^N(n))(d/dn)q^N(n). \quad (7)$$

It follows from (5) that $(d/dn)CS^N(n) > 0$ holds for all n . Thus, it is always to the benefit of consumers to *increase* the number of firms within the class of models we are envisaging. However, it follows from (6), as well as $(d/dn)q^N(n) < 0$, $(d/dn)Q^N(n) > 0$ and $(d/dn)p^N(n) < 0$, which are shown by Suzumura (1995, chapter 1), that $(d/dn)PS^N(n)$ consists of two terms with opposite signs as long as n is less than n_e ; however, it becomes unambiguously negative when $n = n_e$, as the first term in (6) will be zero at $n = n_e$. Thus, it is to the benefit of producers to *decrease* the number of firms from $n = n_e$. In fact, the negative effect of $(d/dn)PS^N(n_e)$ is so dominant vis-à-vis the positive effect of $(d/dn)CS^N(n_e)$ that $(d/dn)W^N(n_e)$ will become unambiguously negative. This implies that the social welfare measured in terms of net market surplus is improved by a marginal *decrease* in the number of firms from its equilibrium value. Thus, it is in society's interest for the government to interfere with the free competitive forces so as to keep the number of firms less than its equilibrium value as long as the government is willing to make up for a loss in consumers' surplus with the concomitant gain in producers' surplus.

Socially Excessive Capacity Investment under Private Incentives

Capitalizing on Suzumura (1995, part 2), we now briefly summarize the welfare effects of strategic commitment to cost-reducing research and development in order to confirm the robustness of the above conclusion.

Consider an industry with n firms producing a single homogeneous good, where $2 \leq n < +\infty$. Firms compete in two stages. In the first stage of the game, each firm makes a strategic commitment to R&D investment in full anticipation of the equilibrium in the second stage, where firms compete in terms of quantities.

Let x_i and q_i be the R&D investment and the output of firm i , chosen, respectively, in the first and second stages. The second-stage variable cost function of firm i is $c(x_i)q_i$, where $c(x_i) > 0$ and $c'(x_i) < 0$ for all $x_i > 0$. Given a profile $x = (x_1, x_2, \dots, x_n)$ of R&D investments, let $G(x)$ be a

game defined by a set of players $N = \{1, 2, \dots, n\}$ and a profile of the second-stage payoff functions $\{p^i \hat{=} N\}$, where p^i is defined by $p^i(q_i, Q_{-i}; x_i) = \{f(q_i + Q_{-i}) - c(x_i)\}q_i - x_i$, and $Q_{-i} = \sum_{j \neq i}^n q_j$.

Let $q^N(x) = (q_1^N(x), q_2^N(x), \dots, q_n^N(x))$ be the Cournot-Nash equilibrium of the game $G(x)$. Assuming interior optimum, $q^N(x)$ is characterized by

$$q_i^N(x)f(Q^N(x)) + q_i^N(x)f'(Q^N(x)) = c(x_i), \quad (8)$$

where $Q^N(x) = \sum_{j=1}^n q_j^N(x)$.

Let G be a game defined by a set of players $N = \{1, 2, \dots, n\}$ and a profile of the first-stage payoff functions $\{p^i \hat{=} N\}$, where p^i is defined by $p^i(x) = p^i(q_i^N(x); Q_{-i}^N(x); x_i)$. Let x^N be the Nash equilibrium of game G , which may be characterized by

$$\sum_{j=1}^n (\partial/\partial q_j) p^i(q_i^N(x); Q_{-i}^N(x); x_i^N) (\partial/\partial x_i) q_j^N(x^N) + (\partial/\partial x_i) p^i(q_i^N(x); Q_{-i}^N(x); x_i^N) = 0 \quad (9)$$

under the assumption of interior optimum. The equilibrium path $\{x^N, q^N(x^N)\}$ is the subgame-perfect equilibrium of our two-stage game.

Throughout this chapter, we assume that the second-stage Cournot-Nash equilibrium $q^N(x)$ is symmetric for any symmetric R&D profile x , that is, that $q_i^N(x) = q^N(x)$, say, for all $i \hat{=} N$ if x is symmetric. We also assume that the first-stage Nash equilibrium x^N is symmetric, i.e., that $x_i^N = x^N$, say, for all $i \hat{=} N$.

To see whether there is any room for rationalizable interference in this arena, we introduce the consumers' surplus $CS^N(x)$, the producers' surplus $PS^N(x)$, and the social welfare in terms of the net market surplus $W^N(x)$ by

$$CS^N(x) = \int_0^{Q^N(x)} f(Z)dZ - Q^N(x)f(Q^N(x)), \quad (10)$$

$$PS^N(x) = \sum_{i=1}^n [q_i^N(x) \{f(Q^N(x)) - c(x_i)\} - x_i] \quad (11)$$

and $W^N(x) = CS^N(x) + PS^N(x)$.

Differentiating $CS^N(x)$ and $PS^N(x)$ with respect to x_i , we obtain

$$(\partial/\partial x_i)CS^N(x) = -Q^N(x)f'(Q^N(x))(\partial/\partial x_i)Q^N(x) \quad (12)$$

and

$$\begin{aligned} (\partial/\partial x_i)PS^N(x) &= \{f(Q^N(x)) + Q^N(x)f'(Q^N(x))\}(\partial/\partial x_i)Q^N(x) \\ &\quad - \sum_{j \neq i} c(x_j)(\partial/\partial x_i)q_j^N(x) - c'(x_i)q_i^N(x) - 1. \end{aligned} \quad (13)$$

At this stage of our analysis, we assume that the second-order condition for payoff maximization in the game $G(x)$ is satisfied at $q^N(x)$, that is, that $a^N(x) = (\partial^2/\partial q_i^2)P^i(q_i^N(x); Q_{-i}^N(x); x_i) < 0$ holds. It is also assumed that the strategic substitutability property holds at $q^N(x)$, i.e., that $b^N(x) = (\partial^2/\partial q_i \partial q_j)P^i(q_i^N(x); Q_{-i}^N(x); x_i) < 0$ ($i \neq j$) is satisfied. Under these assumptions, it is verified in Suzumura (1995, chapter 4), that $(\partial/\partial x_i)q_i^N(x) > 0$, $(\partial/\partial x_i)q_j^N(x) < 0$ ($i \neq j$) and $(\partial/\partial x_i)Q^N(x) > 0$ hold. It follows from (12) that $(\partial/\partial x_i)CS^N(x) > 0$ holds for any x . Thus, the strategic R&D investment is always insufficient from the point of view of consumers; hence, promotion rather than restriction of competition in R&D commitment should be the rational policy prescription from the exclusive viewpoint of consumers' welfare. In contrast, it follows from (13) that the sign of $(\partial/\partial x_i)PS^N(x)$ is ambiguous in general. However, it may be verified by virtue of (8) and (9) that

$$(\partial/\partial x_i)PS^N(x^N) = (n-1)q_i^N(x^N)f'(Q^N(x^N))(\partial/\partial x_i)Q^N(x^N) < 0 \quad (14)$$

holds at the subgame-perfect equilibrium $\{x^N, q^N(x^N)\}$. It follows that the strategic R&D investment is excessive at the subgame-perfect equilibrium; hence, restriction rather than promotion of strategic R&D competition should be the rational policy prescription from the exclusive point of view of producers' benefit.

Turning to the point of view of social welfare defined by the net market surplus, and putting (12) at x^N and (14) together, we obtain

$$(\partial/\partial x_i)W^N(x^N) = -q_i^N(x^N)f'(Q^N(x^N))\{(\partial/\partial x_i)Q^N(x^N) + (n-1)(\partial/\partial x_i)q_j^N(x^N)\}, \quad (15)$$

which is in general of indeterminate sign. However, it is shown in Suzumura (1995, chapter 4) that $(\partial/\partial x_i)W^N(x^N) < 0$ unambiguously holds if the number of firms n is "large enough," which implies that the strategic R&D investment is marginally excessive at the subgame-perfect equilibrium. Thus, restriction rather than promotion of competition in terms of R&D commitment should be the rational policy prescription from the point of view of social welfare defined by the net market surplus measure.

Empirical Relevance

The above theoretical observations have rather strong empirical relevance in the Japanese context. In postwar Japan, interfirm competition has been consistently keen and has played a major role in promoting rapid economic growth by embodying new technology through extensive investment in plant and equipment. So keen has this competition been that a dysfunction of the market mechanism has allegedly developed from time to time, and government intervention has been applied in the name of

keeping “excessive competition” in investment under control. However, hardly anyone has ever defined the meaning of excessive competition within the standard framework of microeconomics. Indeed, most of the common arguments on excessive competition boil down to the assertion that competition is so keen that some of the incumbent firms are forced to retreat from the competitive arena. If this is all that can be meant by excessive competition, there is no real substance to this esoteric term. If one is to gauge the real relevance of alternative stances taken by the industrial policy authorities represented by MITI, the competition policy authorities represented by JFTC, and the Supreme Court in the context of competition versus regulation, the theoretical meaning, if any, of excessive competition should be explored. Recollect in this context that the “excessive competition in investment . . . tends to develop in industries characterized by heavy overhead capital, homogeneous products, and oligopoly. Examples are iron and steel, petroleum refining, petrochemicals, certain other chemicals, cement, paper and pulp, and sugar refining” (Komiya 1975, 213-14). It is in response to this acute observation that the two models summarized above were developed embodying the three crucial features identified by Komiya.

According to the above analyses, one may clearly identify three situations in which excessive competition in the welfare-theoretic sense does or does not surface:

- There is no such phenomenon as excessive competition if one evaluates the performance of competition exclusively in terms of consumers’ surplus.
- If one measures the performance of competition exclusively in terms of producers’ surplus, the competitive equilibrium number of firms (or the subgame-perfect equilibrium level of R&D investment) is excessive at the margin in the sense that a marginal decrease in the number of firms from its long-run equilibrium value (or a marginal decrease in the R&D investment from its subgame-perfect equilibrium level) improves the performance of the industry at the margin.
- If one measures the performance of competition exclusively in terms of net market surplus, the competitive equilibrium number of firms (or the subgame-perfect equilibrium level of R&D investment) is excessive at the margin in that a marginal decrease in the number of firms from its long-run equilibrium value (or a marginal decrease in R&D investment from its subgame-perfect equilibrium level) improves the industry performance at the margin.

It is worth emphasizing that the three performance criteria referred to here are of crucial empirical relevance in the Japanese context. According to Article 2-5 (private monopolization) and Article 2-6 (cartels) of the AML,

a monopolization or cartel is unlawful if and only if it restrains competition substantially in a particular field of trade “contrary to the public interest.” As Matsushita (1990, 16-20) has aptly observed, however, the crucial expression “contrary to the public interest” admits several alternative interpretations, and the choice made among them may dictate the rigor with which one is ready to apply the AML to a private monopolization or cartel. The following three views on the issue of interpretation can be identified, each offering sharply contrasting policy implications:¹

- **The view taken by JFTC.** According to JFTC, the so-called public interest means nothing more than “free competition.” Thus, the expression “contrary to the public interest” simply implies that there is a lack of free competition. This view can be traced back directly to the basic objective of the AML. As stipulated in Article 1, the law is designed to “promote fair and free competition.” If one subscribes to this view held by JFTC, there is no room for an independent performance criterion other than free competition itself in judging whether there should be interference in the working of market competition.
- **The view held by the business community.** The business community in general, and the Federation of Economic Organizations in particular, maintains the view that the “public interest” should be construed to mean something far broader than free competition alone, and that its definition should duly acknowledge the importance of balanced development of the national economy, consumer welfare, and cooperation with foreign countries. In other words, rigorous application of the AML should not be construed as an end in itself, and an interference in the working of free competition may be rationalized if it contributes to the enhancement of a suitably defined measure of social welfare, that is, the “public interest.”
- **The view of the Supreme Court in the oil cartel decision.** In the context of the 1984 decision in one of the oil cartel cases, the Supreme Court took an intermediate view which struck a balance between the view of JFTC and the view held by the business community. According to the Supreme Court, the “public interest” should in principle mean nothing other than free competition, and, under normal circumstances, an anticompetitive agreement among firms should be deemed contrary to the “public interest.” However, inherent in this view is the admission that there are exceptional circumstances under which an anticompetitive agreement may be justified if the disadvantage of interfering in free competition may be offset by the social advantage secured only by an anticompetitive agreement

1. The following discussion of the three interpretations of “contrary to the public interest” owes much to Matsushita (1990).

among firms. Inasmuch as the circumscription of the so-called exceptional circumstances is left unclear, the extent to which the Supreme Court's view diverges from the JFTC view is also left opaque. It is worth emphasizing, however, that the real importance of this view lies in the fact that it admits the existence of the areas in which a comparison—in terms of social welfare—between free competition and anticompetitive regulation should be made before a decision is reached on the application of the AML.

This completes this chapter's preliminary analyses of competition, regulation, and welfare. In the following section, I begin a description of the exemption systems laid down by the AML and other anticompetitive policy measures in postwar Japan.

Overview of the AML Exemption Systems

Current Status of the Exemption Systems

The exemption systems of the AML are designed for the exceptional exemption from that law's prohibitive provisions of anticompetitive agreements (cartels) and the like devised by firms and trade associations.

The AML exemption systems are quite extensive. In June 1991 there existed 68 exemption systems under 42 laws, of which 56 exempted cartel systems under 37 laws accounted for the vast majority. Among these, 30 exemption systems under 15 laws were administered with the authorization of JFTC, or by the competent cabinet minister after having obtained the consent of—or having consulted with or notified—JFTC. The number of cartels under these systems has been decreasing, and some of the exempted cartel systems have been dormant for a long time—indeed, some have never been implemented at all since their introduction. There were 1,079 exempted cartels at the end of March 1966, of which 72 percent involved small and medium-size enterprise associations, 21 percent involved foreign trade, and the remainder involved coastal shipping and other associations of various kinds. The number of exempted cartels was reduced to 505 at the end of March 1982, the most dramatic decrease having occurred in the areas of foreign trade (from 225 to 69) and small and medium-size enterprise associations (from 781 to 461). In June 1991, there were 247 active cartels under six laws, of which 170 involved small and medium-size enterprise associations, 34 involved foreign trade, 37 involved hairdressing, and the remaining six involved coastal shipping and fisheries.²

2. Detailed historical and factual information on the exemption systems in Japan may be found in Fair Trade Commission of Japan (1977; 1991) and Uesugi (1986).

Exempting Laws Currently in Effect

Japan's exemption systems and laws are too numerous to describe here in full detail. In this chapter I refer only to those laws that are both typical and substantially important.

Some exemptions are based on the AML itself, or on components of it such as the Law Concerning Exemption, whereas others are provided for in other laws. AML-based exemptions include natural monopolies (Article 21), intellectual property rights (Article 23), certain activities of cooperatives (Article 24), resale price maintenance (Article 24-2), recession cartels (Article 24-3), and rationalization cartels (Article 24-4).

Table 1 lists the cartels that were exempted from the AML by Article 24-3 (recession cartels) and Article 24-4 (rationalization cartels).

The second category of exemptions includes the following:

- the exemption of legitimate acts performed under laws and regulations, including the Land Traffic Enterprise Coordination Law and the Food Control Law, or orders under such laws and regulations;
- the exemption of organizations and other entities established under specific laws from Article 8 of the AML.

The third category of exemptions is illustrated by the following laws:

- the Marine Transportation Law, which exempts shipping conferences from the AML application;
- the Insurance Business Law, which authorizes rates fixed by fire and marine insurance companies;
- the Road Transportation Law, which exempts trucking, bus, and taxi companies from the AML;
- the Aviation Law, which allows Japanese airline companies to join the international aviation cartels;
- the Export-Import Transactions Law, which authorizes export and import cartels;
- the Small and Medium-Size Business Organizations Law, which allows small enterprises to organize cartels.

Historically Important Exempting Laws

Besides those laws currently in effect, it is worth noting some exempting laws that are of historical importance although they no longer have any influence. The following laws, promulgated on behalf of various manufacturing industries on the basis of their "strategic importance," illustrate the nature of such laws: Law on Temporary Measures for Structural

Table 1 Number of cartels exempted from the Antimonopoly Law, 1954–92

Year	AML Article 24-3	AML Article 24-4
1954	0	0
1955	0	0
1956	0	4
1957	1	6
1958	1	6
1959	5	8
1960	4	9
1961	3	9
1962	0	11
1963	1	11
1964	2	14
1965	2	14
1966	16	14
1967	1	13
1968	0	13
1969	0	12
1970	0	10
1971	0	13
1972	9	10
1973	2	10
1974	0	9
1975	2	0
1976	1	0
1977	1	0
1978	6	1
1979	4	0
1980	1	1
1981	1	1
1982	3	0
1983	2	0
1984	0	0
1985	0	0
1986	0	0
1987	0	0
1988	2	0
1989	2	0
1990	0	0
1991	0	0
1992	0	0

Source: Fair Trade Commission of Japan, *Annual Report 1992* (Tokyo: Fair Trade Association, 1993). Attachments, 58–59.

Improvement of Specified Industries (May 1978-June 1988), Law on Special Measures for the Promotion of the Machinery Industry (June 1956-March 1971), Law on Special Measures for the Promotion of Electronics Industry (June 1957-March 1971), Law on Temporary Measures for the Promotion of Specified Electronics Industries and Specified Machinery Industries (April 1971-March 1978), and Law on Temporary Measures for the Promotion of Specified Machinery and Information Industries (July 1978-June 1985).

Table 2 summarizes the historical pattern of cartels that were exempted from the AML by the five laws listed above. Note that all these laws of historical importance had completely ceased to be effective by June 1988 if not earlier.

Evaluations

Most of the modifications of the original and procompetitive AML resulted from tensions between MITI and JFTC, which started soon after the enactment of the AML. The first government-organized cartel was introduced in February 1952, when MITI issued an administrative guidance to 10 large cotton spinners to reduce production by 40 percent. To enforce the quotas assigned by MITI, it was informally suggested that the foreign currency assignments under MITI's control for the following month's supply of raw cotton might be unavailable to those who rejected the quotas. Such cartels, organized as well as enforced by MITI, have proliferated since then, despite the accusation by JFTC that MITI's administrative guidance was illegal. To strengthen MITI's legal position vis-à-vis the AML, MITI soon submitted to the Diet the Law on Special Measures for the Stabilization of Designated Medium Size and Small Enterprises and the Exports Transactions Law, which authorized MITI to create cartels among small businesses without their being constrained by the AML.

This movement toward securing a safeguard against the AML applications was not confined to medium-size and small enterprises. Indeed, in 1953 the Steel Federation, as well as the Federation of Economic Organizations, petitioned the Diet to permit recession cartels and rationalization cartels. MITI also asked for the power to approve not only recession cartels and rationalization cartels but also other cooperative behavior adopted to restrict production and sales. It was against this background that the Diet amended the AML in September 1953 to approve recession and rationalization cartels. Furthermore, beginning with the Law on Special Measures for the Equipment of the Textile Industry (1956), the Law on Special Measures for the Promotion of the Machinery Industry (1956), and the Law on Special Measures for the Promotion of the Electronics Industry (1957), MITI began to implement a series of industry laws which secured exemptions from the AML for the designated industries.

MITI's persistent attempts to secure powerful institutional devices for controlling market competition culminated in its 1958 plan for a "public sales system" for the steel industry, which was, quite surprisingly, approved by JFTC. The widely held perception that JFTC would approve anything that MITI claimed was necessary to the well-being of Japan seems to be deeply rooted in this dark period of competition policy.

Table 2 Number of cartels exempted from the Antimonopoly Law, 1957–88

Year	A	B	C	D	E
1957	–	0	–	–	–
1958	–	0	0	–	–
1959	–	0	0	–	–
1960	–	1	0	–	–
1961	–	1	0	–	–
1962	–	5	0	–	–
1963	–	6	0	–	–
1964	–	14	0	–	–
1965	–	14	1	–	–
1966	–	9	1	–	–
1967	–	6	1	–	–
1968	–	8	0	–	–
1969	–	17	0	–	–
1970	–	16	1	–	–
1971	–	17	2	–	–
1972	–	–	–	0	–
1973	–	–	–	13	–
1974	–	–	–	15	–
1975	–	–	–	17	–
1976	–	–	–	16	–
1977	–	–	–	15	–
1978	–	–	–	9	–
1979	5	–	–	–	1
1980	8	–	–	–	1
1981	8	–	–	–	2
1982	4	–	–	–	1
1983	4	–	–	–	1
1984	5	–	–	–	1
1985	7	–	–	–	1
1986	6	–	–	–	–
1987	5	–	–	–	–
1988	2	–	–	–	–

– = not applicable.

A. Law on Temporary Measures for Structural Improvement of Specified Industries: May 1978–June 1988.

B. Law on Special Measures for the Promotion of the Machinery Industry: June 1956–March 1971.

C. Law on Special Measures for the Promotion of the Electronics Industry: June 1957–March 1971.

D. Law on Temporary Measures for the Promotion of Specified Electronics Industries and Specified Machinery Industries: April 1971–March 1978.

E. Law on Temporary Measures for the Promotion of Specified Machinery and Information Industries: July 1978–June 1985.

Source: Fair Trade Commission of Japan, *Annual Report 1992* (Tokyo: Fair Trade Association, 1993). Attachments, 58–61.

In view of the historical background of the AML exemption systems and other measures for controlling competition, the evaluation of institutional anticompetitive devices becomes almost tantamount to the evaluation of Japanese industrial policy. Leaving this larger task to much more extensive studies such as Itoh et al. (1991), Johnson (1982), Komiya, Okuno,

and Suzumura (1988), and Okimoto (1989), I shall make only two brief observations.

First, there is little solid proof, if any, that MITI's protective intervention into the mechanism of free competition through its measures to control competition was indispensable to recovery, rationalization, rapid economic growth, and adjustment to external shocks in the postwar Japanese economy. Indeed, the effectiveness of the government-sanctioned cartels has been seriously questioned. For example, in his analysis of the competitive consequences of Japan's export cartel associations, Dick (1992, 280) concluded that "Japanese export cartels appear to have had no statistically significant effect upon either export prices or quantities," and suggested that "several seemingly anti-competitive provisions of Japanese antitrust law, including the limited antitrust exemption for resale price maintenance and the exemption for private depression cartels, appear in practice to have allowed efficient forms of competition to emerge" (Dick 1992, 291). More recently, Weinstein (1993) concluded in an evaluation of the administrative guidance and cartels in Japan that "MITI's guidance and cartel policies seem to have had rather small impacts on firm behavior," and that "in comparison to the favorable tax treatment, subsidies, protection, and low interest loans that some sectors received, exemptions from the virtually defunct Anti-Monopoly Law seem like relatively mild forms of government intervention."

Second, it can hardly be denied that MITI had often outmaneuvered JFTC, at least until the early 1970s. However, there were two changes in the mid-1970s and thereafter that are worth mentioning. In the first place, there was a sharp and outright confrontation between MITI and JFTC when in February 1974 JFTC charged the Petroleum Association of Japan and 12 petroleum companies with operating an illegal price cartel. The case was turned over to the Tokyo High Public Prosecutor's Office. What was unique about this case was that the petroleum companies pleaded not guilty, saying that whatever they had done collectively had been done in accordance with MITI's administrative guidance. Although MITI was not charged in this context and neither was MITI's administrative guidance openly referred to in the indictment, the very fact that MITI's administrative guidance underlay the first criminal prosecution for a violation of the AML clearly indicated that the day had long passed when MITI could impose its anticompetitive measures on JFTC with impunity. In the second place, the lenient nature of the AML in Japan has become one of the focal issues of the US-Japan Debates on Structural Impediments Initiatives. In response to this external pressure, JFTC has recently reviewed and reevaluated systems of exemption to the AML in Japan. It seems safe to surmise that, whatever effects one may be ready to associate with the current exemption systems and other anti-competitive measures, these systems and measures are in the process of being curtailed, if not actually extinguished.

Case Study I: Entry Regulation in the Japanese Retail Industry

Formal Structure of the Large-Scale Retail Store Law

Since large firms tend to be technically more efficient than small firms, substantial social conflict occurs when a few large firms come to compete with many small firms in a segmented market. From the point of view of technical efficiency, it may be better to have fewer and larger firms rather than more and smaller ones. However, apart from the problem that a larger proportion of overall market power would then be held by these larger firms, there are at least two countervailing considerations. First, more often than not larger firms are newcomers to the segmented (“local”) market, in which smaller firms have been engaged in hand-to-mouth business over many years or even generations. Hence, the arrival of larger rivals may be viewed as eradicating fair and rightful business opportunities for those who have been totally committed to the local market. Second, smaller firms, being predominant in number, are capable of exerting strong political pressure on the government, which may result in some governmental measures being taken to regulate, if not blockade, the entry of technically superior and larger firms into a local market. One can best appreciate how these considerations interact, and how they tend to generate a complex and informal system of entry regulation, by examining the local retail markets.

I shall begin by describing the formal system of entry regulation in local retail markets that existed until the recent reform, and will then explain the huge divergence that subsequently developed between this lawful framework and the actual *modus operandi* of entry regulation.³ It is my hope that this case study will illustrate the difficulties that must be faced in attempting to design and implement a welfare-enhancing entry regulation, and that it will suggest how great the social cost of less-than-ideal anticompetitive market intervention can be.

The formal structure of the Law Concerning the Adjustment of Retail Activities by Large-Scale Retail Stores (referred to hereafter as the Large-Scale Retail Store Law), which was enacted in 1974 and replaced the foregoing Department Law, is fairly simple and straightforward. According to Article 1 of the law, its purpose is to keep the retail activities of large-scale retail stores under due control, thereby securing fair business opportunities for local small and medium-sized retailers, and to main-

3. This section is based essentially on Suzumura (1990c). See also Kusano (1992) and Tsuruta and Yahagi (1991).

tain the well-balanced development of retail industry in the area without sacrificing consumers' benefits.⁴

Whenever a large-scale retailer intends to start a new store whose size exceeds 500 square meters in a local retail market, that retailer must follow the accommodation procedure stipulated by the law.⁵ In the first place, those who intend to build the large-scale retail store must notify MITI of their construction plans through the local municipality. This is known as the Article 3 notification. Once this notification is filed, MITI should make it known to those who are likely to be affected by the proposed entry that a formal process of accommodation in accordance with the law is about to start. After this first step is completed, the second notification to MITI, the so-called Article 5 notification, must be filed at least five months before the opening of the store in question through the local municipality by those who are going to engage in retail business activities in the proposed large-scale retail store. This second notification must include such information as opening date, total floor space, and frequency of discount sales. If MITI feels that the opening of the proposed store may adversely affect the business opportunities of small local retailers beyond a reasonable limit, it is within MITI's jurisdiction to recommend that the potential entrant delay the opening of the store or reduce the planned floor space, or both. This recommendation should be made within four months after the Article 5 notification is filed. In doing this, MITI should consult the Large-Scale Retail Store Council, an advisory group under MITI's jurisdiction, for its opinion concerning the necessity and content of a recommendation. The council, being rather distant from local circumstances and opinions, will consult the local Chamber of Commerce for its opinion; the latter in turn will organize a Council to Accommodate Commerce Activities (CACA), whose function is to hold discussions to accommodate local

4. This declared purpose of the law seems to contain some possibilities of internal inconsistency. In particular, it is not at all clear how one can protect the "fair" business opportunities of local small retailers by the entry regulation of large-scale stores, which tend to be more efficient and capable of providing a wider product range to local customers, without sacrificing consumers' benefits.

5. According to the original 1974 law, a large-scale retail store is one whose total floor space exceeds 1,500 square meters. This stipulation only induced an increase in the number of retail stores whose total floor space was $1,500 \text{ m}^2 - e$, where e is positive but small. Partly in response to this induced tendency and partly in response to the additional regulations introduced by local municipalities that covered retail stores with total floor space less than 1,500 square meters, the law was modified in 1979 so as to define a large-scale retail store as one whose total floor space exceeds 500 square meters. This definition lasted until January 1992, when the law was again modified in response to the US-Japan Debates on Structural Impediments Initiatives. In order to facilitate new entry of large retailers, the critical total floor space of retail stores was raised to 3,000 square meters. For more factual details on the history and content of the Large-Scale Retail Store Law, see Suzumura (1990b) and Kusano (1992).

interest groups. It is noteworthy that the formal members of CACA consist of local business representatives *excluding* those who are directly affected by the large-scale retail store in question, plus consumer representatives and neutral third parties, including informed academics.⁶

The maximum allowable length of time for this accommodation process is obviously limited by the maximum time allowed between the Article 5 notification and MITI's lawful recommendation. As a matter of fact, MITI's administrative guidance recommended that this period be restricted to two months. Therefore, it should be possible under the law to open a new large-scale retail store within as little as seven months of filing the Article 3 notification, as long as the original entry plan is duly modified in full accordance with any MITI recommendation. If MITI's recommendation is not voluntarily complied with, then it can issue a legal order to enforce its lawful recommendation.

This formal accommodation procedure is briefly summarized in figure 1. It should be clear that the Large-Scale Retail Store Law empowers no one, not even MITI officials and local municipalities, to *reject* new entry into a local retail market, as long as the two notifications are filed in time and MITI's recommendation based on the formal procedure is duly observed.

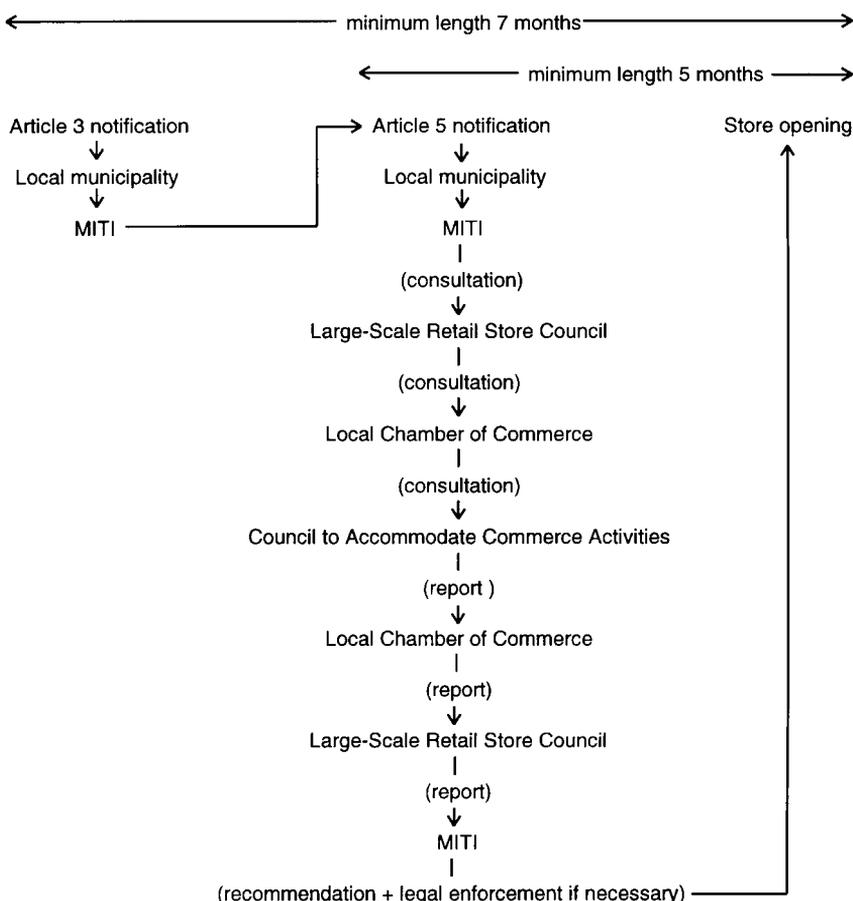
Actual Working of the System of Entry Accommodation

In reality, actual accommodation procedure has been completely different from what has been described so far. In some cases, the formal accommodation procedure can begin only after quite lengthy and unofficial *ex ante* negotiations with local interest groups have been successfully carried out, which sometimes can take as long as five years. In view of this prolonged and painful process of accommodation, which is obviously costly to those wanting to enter a local retail market, there have been cases in which attempted entry plans were abandoned or shifted to another area. There seem to be at least two reasons why this happens, one involving MITI's administrative guidance and bureaucratic conventions and another involving additional regulations brought in by local municipalities.

The first step in the erosion of the official accommodation procedure is that it soon became a bureaucratic convention that MITI consulted the opinion of the local Chamber of Commerce between the two lawful notifications, the reason presumably being to facilitate better reflection of local opinions in the final settlement. Since the official CACA is formed

6. To be precise, there is no explicit stipulation in the law concerning the role of the Council to Accommodate Commerce Activities. It was MITI's administrative guidance that first introduced this council. Its role was made more official in the 1982 revision but was never been formally included in the law itself.

Figure 1 Formal accommodation procedure



only *after* the Article 5 notification is filed and the Large-Scale Retail Store Council has consulted the local Chamber of Commerce, it was necessary to introduce another informal council, without any lawful status whatsoever, which dealt with the substantial matter of accommodation as it concerned floor space, opening date, holidays, and opening hours. This informal council came to be called the Prior CACA, and it lies completely outside the lawful accommodation procedure, with two regrettable consequences.

First, in contrast to the situation with the official CACA, there was no time limit on the accommodation within the Prior CACA, nor was there any accountable restriction on the Prior CACA's membership. Second, this informal council in effect preempted the formal accommodation procedure as laid down in the Large-Scale Retail Store Law. It was inevi-

table that much time thereby came to be wasted, but the more serious problem was that the lawful accommodation procedure was deprived of its substance. That the official CACA came to be dubbed the “Confirmation CACA” is symbolic of the extent to which it was undermined by the unofficial Prior CACA.

To rectify the situation, in May 1979 MITI introduced administrative guidance to the effect that the length of time between the Article 3 and Article 5 notifications should not exceed eight months. This, in effect, set an upper limit of eight months on the allowable period of accommodation within the Prior CACA. In response to this administrative guidance, however, a bizarre practice came into being. The Preliminary Explanation by the potential entrant to the local interest groups, which was also introduced by MITI’s administrative guidance as a prerequisite to official filing of the Article 3 notification, transformed itself into the Prior-Prior CACA, within which the whole substance of the accommodation procedure was in effect completed. As this Preliminary Explanation had to be completed before filing of the Article 3 notification, there were no legal stipulations on the membership of the Prior-Prior CACA; nor was there any constraint on the content and length of negotiations within it.

Along with this erosion of the entry regulation system administered by the central government, many local municipalities introduced additional entry regulations which made the actual entry accommodation procedure even more opaque and inefficient. On the one hand, some local municipalities required that the agreement concluded within the Prior-Prior CACA be appended to the Article 3 notification. This administrative practice has no legal foundation in the Large-Scale Retail Store Law itself, however.⁷ On the other hand, many local municipalities extended the scope of entry regulations based on the Large-Scale Retail Store Law, intending to cover retail stores with floor space far less than the legally stipulated 500 square meters.⁸ In extreme cases, local entry regulation was applied to retail stores whose floor space exceeded just one square meter when the store was funded by someone residing outside the municipality in question. Figure 2 summarizes the actual entry regulation system in local retail markets schematically.⁹

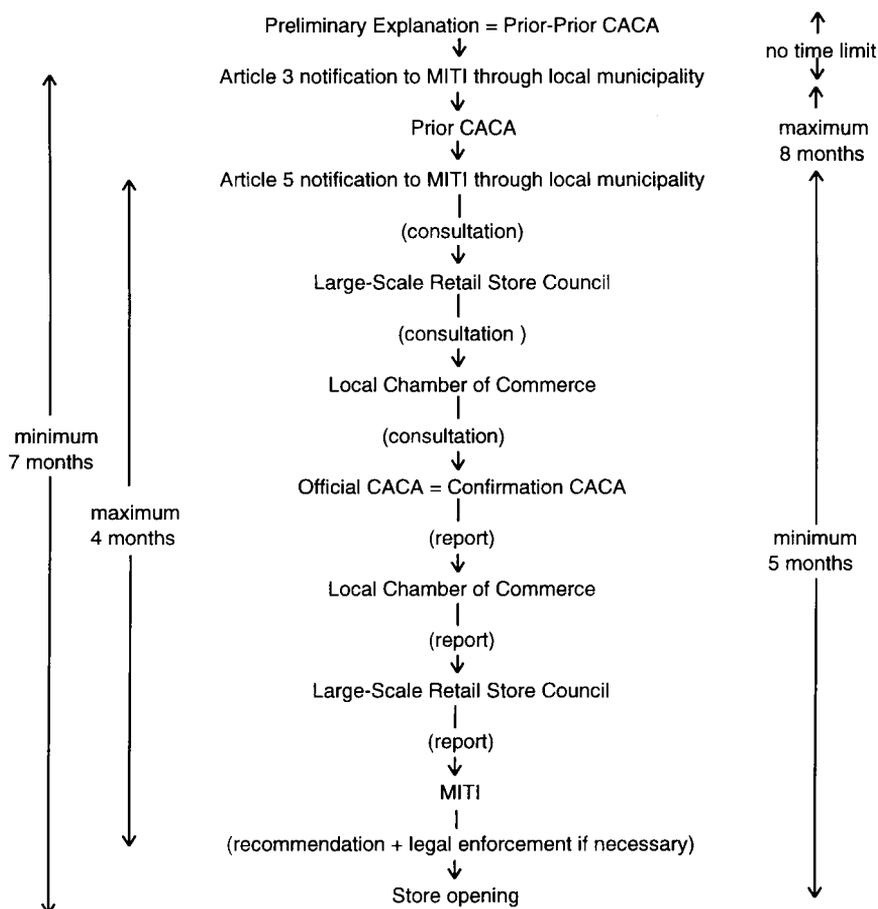
Given this labyrinth of informal entry regulations, it is all too common for many large-scale retail stores to be effectively blocked from

7. In March 1989, there were 117 local municipalities that had their own entry regulations governing large-scale retail stores, in addition to the regulations based on the Large-Scale Retail Store Law; see Kusano 1992, 28.

8. In March 1989, there were 1,014 local municipalities regulating the entry of retail stores with floor space less than 500 square meters; see Kusano 1992, 28.

9. This scheme persisted until May 1990. It was in response to US criticism of this grotesque arrangement that the first step was taken to make it more efficient and more accountable; see section 4.3 below.

Figure 2 Informal accommodation procedure



entering local markets, or “voluntarily” to shift away from local markets known for their vigorous entry-preventing activities, to the clear detriment of local consumers. If and when an attempted entry does prove successful, the entry “fee,” in the form of forgone imputed rent on the prospective store site, the cost of lengthy negotiations, and pecuniary or nonpecuniary compensations paid out to local retailers, is ultimately passed on to local consumers.

The story told thus far should not be interpreted to suggest that large-scale retailers have been unilaterally sacrificed and exploited by incumbent small and medium-size retailers through the informal mechanism of entry regulations. The reason is as follows: Since most large-scale retailers have repeatedly played this entry regulation game, even when they are compelled to pay compensation for their attempts to enter a

local market, the same mechanism effectively protects them from future attempts at entry by their rivals. It follows that the initial entry “fee,” which is shifted to customers after entry anyway, is in fact considered money well spent from large-scale retailers’ point of view. Thus, not only small and medium-sized retailers, but also the large-scale retailers themselves, are beneficiaries of this informal mechanism of entry regulation. This is one of the crucial reasons why the mechanism has been so robustly preserved, despite its obvious inefficiency, unfairness, and lack of transparency.

Prospects for Regulatory Reform in the Japanese Retail Industry

Entry regulations in the retail industry became the symbolic focus of the US-Japan Debates on Structural Impediments Initiatives. In response to criticisms raised by the US representatives of the supplier-oriented nature of administrative practices in Japan, several important steps have been taken to improve both the formal structure of entry regulations and administrative practices.

The initial step was taken in May 1990, when MITI issued a circular to all municipalities and Chambers of Commerce. In it, the ministry requested that the maximum period of accommodation be shortened to 18 months total, and that the improper use of the Preliminary Explanation as the Prior-Prior CACA be terminated. The law itself was revised in May 1991 and became effective nine months later. The revised law stipulated that the total period of accommodation should be less than one year; it also simplified the accommodation procedure by placing accommodation-related activities exclusively in the hands of the Large-Scale Retail Store Council. It is worth emphasizing that neither the Prior CACA nor the official CACA itself, which symbolized the deformed accommodation procedure, has any role whatsoever in this newly revised procedure.

The immediate response to the revisions was remarkable. Within one month of MITI’s May 1990 circular, more than 1,500 large-scale retail stores announced their intention either to open a new store or to upgrade their existing store(s). This figure was three times larger than the total number of Article 3 notifications filed in all of 1989. It spoke eloquently to the severity of the entry regulations and indicated how many potential entries had had to remain latent.

Although implementation of this regulatory reform may not be easy for various reasons, the shift toward more transparent and consumer-oriented entry accommodation mechanisms should be welcomed. Note, however, that the Large-Scale Retail Store Council faces a prodigious task in view of the number of proposed new entries. It is not clear how the council will cope with this responsibility. In addition, it is not clear

how the extended use of entry regulations by local municipalities, which was one of the major reasons for the failure of the former accommodation procedure, can be effectively contained without violating the important principle of local autonomy.

With the conclusion of this case study, a general remark seems in order. Even when the formal system of market intervention is straightforward, it may be made complex and internally inconsistent by a sequence of administrative guidances which, by their very nature, lack a basis on any clear and logical procedural restriction. The situation is even worse when the formal system itself contains some internal logical inconsistencies. Indeed, what underlies the quagmire of entry regulations in the Japanese retail industry is a conflict between two very basic requirements of social policy: efficiency of industry performance, on the one hand, and protection of the “right” of those who have been engaged in local business long before the proposed entry of their large rivals, on the other hand.¹⁰ Once it is agreed that the “right” in question is worth social protection, the concomitant loss of social efficiency may be regarded as a cost to be borne collectively. Even in this case, however, one can design a much more efficient and straightforward mechanism for protecting this “right” than leaving the issue to be settled through the complex procedure of endless negotiations and compensations. However, if the general validity of such a “right” is not universally agreed upon, the *raison d’être* of entangled negotiation procedure will be that much less.

Case Study II: Telecommunications Reform and Handcuffed Competition

Telecommunications Reform of 1985

The telecommunications industry is under the jurisdiction of the Ministry of Posts and Telecommunications (MPT). In 1985, MPT introduced an extensive telecommunications reform which is apparently procompetitive in nature. Before the implementation of this important reform, Nippon Telegraph and Telephone Public Corporation had legally monopolized domestic telecommunications in Japan. My second case study focuses on the nature and aftermath of this reform, with special emphasis on the public decision-making mechanism that led to this reform.¹¹

10. This basic conflict reflects itself in Article 1 of the law; see footnote 4.

11. For the sake of brevity, the following explanation greatly simplifies matters. See Suzumura (1990a) and Okuno-Fujiwara, Suzumura, and Nambu (1993) for a more detailed account and analysis of the 1985 telecommunications reform.

The origin of the 1985 reform can be traced back to the Third Report of the Second Ad Hoc Commission on Administrative Reform, which was submitted to the prime minister in 1982. To understand the nature of this report and its enforcement, a brief account of the nature of this Ad Hoc Commission is provided here.

Historically speaking, it was the Occupation authorities who encouraged participatory democracy in order to reduce and rectify the arbitrary nature of Japan's prewar administration. With the implementation of the National Administrative Organization Law in 1949, the government ministries began to establish advisory bodies on the level of cabinet ministers, bureau chiefs, and section chiefs. These advisory bodies are classified into "consultative bodies," which deliberate on policies, and "examining bodies," which, by participating in administrative decision making, ensure that the laws are fairly administered. A report submitted by a consultative body is not binding, whereas the resolution of an examining body can serve as a legal constraint on bureaucracy. Thus, it is clear that examining bodies are far stronger administrative committees than consultative bodies in terms of their degree of independent authority; furthermore, examining bodies are grounded in Article 3 of the National Administrative Organization Law.

Although the Second Ad Hoc Commission was a consultative body grounded in Article 8 of the National Administrative Organization Law, its reports were considered virtually legally binding, owing to the fact that the prime minister had publicly promised the chairman of the Second Ad Hoc Commission that his government would faithfully implement its recommendations.

Concerning the telecommunications industry, the Third Report made the following recommendations:

- Nippon Telegraph and Telephone Public Corporation should be privatized.
- This public corporation should be divided into a central corporation, which would manage the long-distance network, and local corporations, which would manage the local networks in their respectively designated areas.
- The telecommunications industry should be liberalized and new entry into the long-distance market should be encouraged.¹²

12. The background of these radical recommendations seems to be threefold. First, under the legal monopoly enjoyed by Nippon Telegraph and Telephone Public Corporation, the telecommunications industry in Japan was not responsive enough to rapidly expanding and diversifying customer needs. Second, the extent of the internal inefficiencies of the state monopoly seemed to have far exceeded the limits of public tolerance. Third, owing to innovations in telecommunications technology, the traditional reason for state monopoly, that is, natural monopoly, seemed to have disappeared at least as far as long-distance telecommunications were concerned.

Of these three recommendations, the first two were indeed implemented by the 1985 telecommunications reform. The Nippon Telegraph and Telephone Public Corporation was transformed into a special government-controlled private company called NTT. In addition, in 1987 three new common carriers (NCCs) selectively entered the long-distance market and started telecommunications services in the most profitable market segment. Concerning the third recommendation, however, no firm commitment to its implementation was made in the 1985 reform. It was simply announced that the performance of the new organization of the telecommunications industry in general, and the performance of NTT in particular, would be reviewed after five years with the purpose of deciding what further steps should be taken. At the time of the 1985 reform, therefore, NTT remained a consolidated common carrier and continued to monopolize the local telecommunications market.

The 1984 procompetitive reform notwithstanding, the telecommunications industry has remained highly regulated, and the nascent competition between the privatized NTT and the newly arrived NCCs has been hampered by MPT's incessant interference. Not only NTT, but also the NCCs, have been subject to MPT's price and service regulations, which seem to have been guided by MPT's industrial policy aimed at promoting the NCCs as an effective countervailing power against the bottleneck monopolist, that is, NTT. Indeed, at least up to June 1992, there had always been a 20 percent difference in the NCCs' favor between the rates charged by NTT and the NCCs for long-distance telephone services. This difference sufficed to bring about a rapid shift in the long-distance telephone market from NTT to the NCCs.¹³

Not only the entry of potential firms into this industry, but also the exit of incumbent firms from the industry, is under the strict surveillance of MPT. Since NTT was not divested in the 1985 reform but retained its integrated network, a fundamental asymmetry persists between NTT and the NCCs. Thus, each NCC can complete its long-distance telecommunications service only by being smoothly connected with NTT's local network, whereas NTT can provide a self-contained telecommunications service. Given this structural asymmetry between NTT and the NCCs, it makes sense that there should remain an asymmetric regulation in order to keep NTT's bottleneck monopoly under proper control. However, the current intervention by MPT would seem to go far beyond such rule-oriented and procompetitive regulation and to interfere with the choice of competitive strategies by the market participants. The current method of price regulation, which remains the classical rate-of-

13. The NCCs' share of long-distance telephone service between Tokyo and Osaka via Nagoya was already as high as 40 percent in 1990 and came close to 60 percent in 1992. Given that the NCCs started their service only in 1987, this drastic shift in market share is truly remarkable.

return regulation, is not really procompetitive either. Besides, MPT has never allowed NTT to rebalance its rate structure, with the result that the local telephone charge has remained absolutely fixed ever since the 1985 reform, in the face of a sharp decrease in the long-distance telephone charges arising from the introduction of controlled competition in this segment of the market.¹⁴

In 1988, MPT sought the opinion of the Telecommunications Deliberation Council, the advisory body at MPT level, on further measures to be adopted with the purpose of improving NTT's performance. In March 1990, the council submitted a report to the minister of posts and telecommunications on several possible measures that could be taken, including the vertical divestiture of NTT into two parts: the Long-Distance Network Corporation and the Local Network Corporation. However, this report failed to attract support from other ministries, including MITI and the Ministry of Finance—the ruling Liberal Democratic Party was likewise uninterested—and the implementation of recommendation 2 of the Second Ad Hoc Commission had to be postponed for another five years.

Public Decision-Making Process of the 1985 Reform

In Japan there exists a traditional one-to-one correspondence between an industry and the ministerial bureau, division, or section under whose jurisdiction the industry in question falls. Whenever a new development disrupts or blurs this delicately balanced relationship, inevitably a jurisdictional dispute among ministries breaks out. This was indeed the case in the 1970s and early 1980s, when MPT and MITI had a jurisdictional dispute over data processing. MITI's concern was not to lose its influence in data-processing and information services. In addition, some large corporations under MITI's jurisdiction were complaining that they were being prevented from setting up nationwide value-added networks (VAN) between companies; nor were these companies satisfied by the high cost of long-distance calls and the lack of customized billing. It is true that the Third Report of the Second Ad Hoc Commission on Administrative Reform took a clear initiative in designing NTT's privatization and divestiture, but MITI's strong and explicit concern also played an undeniable role throughout the public debate over the privatization of NTT and the liberalization of the telecommunications industry in general, and over data communications in particular.

14. In February 1988, shortly after the NCCs first started providing long-distance telephone services, NTT's charge for the longest-distance telephone service (three minutes, daytime) was ¥360, whereas the corresponding charge by the NCCs was ¥300. These charges were lowered to ¥330 versus ¥280 in February 1989, ¥280 versus ¥240 in March 1990, and ¥240 versus ¥200 in March 1991. During and after this period, NTT's charge for local telephone service (three minutes, day or night) remained absolutely fixed at ¥10.

Although jurisdictional disputes such as the one between MPT and MITI are often viewed cynically, there is a positive side, which is illustrated by looking at the process by which further measures for improving NTT's performance were discussed during 1988–90. NTT being within MPT's jurisdiction, it was the Telecommunications Deliberation Council that came to the fore at this time. As is always the case, the deliberation process within the council was closed to the public, and those who testified in the council's meeting were strongly urged not to disclose any information outside the council. If it were not for other organs, such as the other ministries or business organizations which expressed strong concern and publicized alternative opinions on and scenarios for further telecommunications reform, the general public would not have known what was really at stake. Thus, an imperfect—yet workable—mechanism for checks and balances, that is, the expressed interest of the concerned ministries combined with concomitant jurisdictional disputes, may play some positive role in such a situation by bringing the real policy issues under debate to public awareness.

It goes without saying, however, that it would be much better if there were more dependable and transparent mechanisms through which bureaucratic arbitrariness and unfairness in the form of administrative guidance could be systematically contained. From this point of view, the importance of the Administrative Procedure Law, which was promulgated in November 1993 and stipulates the lawful limits and legitimate procedures of administrative guidance, cannot be overemphasized. For the first time, it is made explicit that compliance with administrative guidance must be strictly voluntary, and there should not be any retaliatory action on the part of the government bureaucracy when the guidance fails to bring about voluntary compliance. It is also significant that the law stipulates that the contents of the administrative guidance, as well as the identity of the person in charge of it, be formally put in writing and provided to those who are subject to the guidance in question. It is hoped that the effective invocation of this law will make administrative procedures in Japan more accountable and transparent in the future.

What's Wrong with Controlled Competition?

In view of the fact that competition has been keen in the long-distance telecommunications market and that customers are gaining from lower long-distance telephone charges without being required to pay higher local telephone charges, a devoted consequentialist may ask: What's wrong with handcuffed competition? However, it seems that such a competition is indeed wrong, for at least two reasons.

First of all, by controlling long-distance telephone charges in such a way that the NCCs can always maintain a substantial competitive edge over NTT, the authority in charge of handcuffed competition is in fact

depriving the NCCs of any incentive to compete in terms of strategies other than controlled prices. A regrettable consequence is that customers miss out on the opportunity to choose from a wider range of services that would be competitively provided were it not for artificially maintained differentials in long-distance telephone charges.

Second, by maintaining artificially low local telephone charges, the authority in charge of handcuffed competition is foreclosing on the potential entry of the NCCs into the local telecommunications market where NTT is still maintaining a virtual bottleneck monopoly. If it were not for the prohibition on revisions to local telephone charges, there might be a spontaneous growth of countervailing competitive power in the local telecommunications market.

It cannot be denied that unfettered competition can be downright wasteful, but handcuffed competition can also cause waste by suppressing spontaneous development which only free market competition can nourish. It is not at all clear which is the lesser of the two "evils."

Antimonopoly Law Guidelines Concerning Joint R&D

Positive and Negative Effects of Collaborative R&D

Apart from anticompetitive interference in the form of entry and exit regulations and rationalization and recession cartels under government auspices, there are cases in which government promotes cooperative behavior among competitive firms. The most important example in post-war Japan is public assistance to collaborative R&D activities through pecuniary and nonpecuniary policy measures.¹⁵ A crucial feature of such government-assisted collaborative R&D is that the joint efforts are deliberately focused on "precompetitive" R&D, which is aimed at disseminating knowledge in nonmarketable form in full awareness that the recipient firms commercialize the knowledge or process in the "competitive" stage.¹⁶ There is widespread interest in this institutional arrangement for promoting R&D, and there are proponents who claim that the AML regulations governing this class of collaborative agreements among competing firms should be made more lenient. It is in this context that

15. This section is based largely on Suzumura and Goto (1995).

16. The best-known example of government-assisted collaborative R&D is the Very Large-Scale Integrated Circuit Research Association (VLSI, 1976-80), which was designed to develop the advanced semiconductor technology that would enable Japanese computer firms to compete with the fourth-generation IBM computers. See Suzumura and Goto (1995) for an evaluation of the VLSI Research Association.

the AML Guidelines Concerning Joint R&D, which were recently published by JFTC, deserves special attention.

I will start by summarizing the pros and cons of such collaborative R&D agreements in general terms. It is widely believed that collaborative R&D has the following positive effects: First, it is necessary for firms to reveal a portion of information concerning a project if they are to raise funds for R&D individually in imperfect capital markets; this reduces their incentive to embark on such R&D projects. However, collaborative R&D arrangements could overcome this barrier and lead to an increase in aggregate R&D. Second, R&D collaboration may improve R&D efficiency if member firms can bring in complementary expertise.¹⁷ Third, R&D competition with the feature of rank order competition, in which the firm that achieves the R&D goal ahead of others reaps most of the fruits, may motivate firms to scurry simultaneously to accomplish the same R&D objective, with the result being a lower social rate of return on additional private R&D. The device of R&D collaboration may prevent this wasteful duplication of R&D resources.¹⁸ Fourth, an R&D collaboration may cope effectively with the problem of appropriability, thereby increasing the aggregate R&D. Indeed, by internalizing R&D externalities, the member firms of an R&D collaboration can appropriate the benefits of R&D, although outsiders can still free ride on R&D spillovers. The diffusion of technological information among member firms can be easier and more assured under an R&D collaboration than under a regime of competitive R&D.

Against these potential benefits, however, there are certain dangers inherent in the institutional device of collaborative R&D. First, R&D collaborations may lead to an excessively high price for technology by reducing competition in the technology market. Second, R&D collaborations may lead to dynamic inefficiency by reducing R&D efforts collectively. This is a real danger which may be exemplified by the case of the US automobile manufacturers' attempt to slow down R&D in pollution-control technology. Third, collaborative behavior at the R&D level by otherwise competing firms may spill over to the product market, that is, collusion on the R&D stage may pave the way for collusion in the stage of product market competition.

17. For example, a ceramic manufacturer and an automobile manufacturer could develop a ceramic engine more effectively in a collaborative effort than if each of them pursued the same R&D project independently.

18. If various approaches are possible to solve the same research problem, and if each firm pursues a separate approach, then competitive R&D may make more sense. However, this type of parallel R&D through competition is unlikely to materialize. The possibility of duplication is high, because each firm will try to keep its approach secret under the competitive R&D regime. If decision making is centralized through collaborative R&D, it is possible for the firms to diversify their approaches deliberately and pursue parallel development strategy intentionally, thereby making the allocation of R&D resources more efficient.

In order to design an effective collaborative R&D policy, it is clearly necessary to pay due attention to these negative effects along with the previously enumerated positive effects.

JFTC Guidelines

In April 1993, JFTC published the Antimonopoly Law Guidelines Concerning Joint Research and Development (hereafter referred to as the JFTC Guidelines) and clarified its general stance regarding collaborative R&D arrangements. The following salient features of these guidelines are particularly worth noting:

- The guidelines are universally applicable to all attempts at collaborative R&D as long as they may exert an anticompetitive effect in the Japanese market, irrespective of whether the participants are domestic or foreign firms.
- Collaborative R&D projects that would encounter problems under the AML would be those undertaken by competitive firms. There is very little likelihood that collaborative R&D projects among noncompetitive firms would pose problems under the AML.
- In passing judgment on whether or not competition in the market is substantially restrained by a particular joint R&D project, the number of member firms and their share of and position in the market are taken into account. If the combined market share of the members is no more than 20 percent, this will usually present no problem under the AML. Even when the total share exceeds 20 percent, however, this does not automatically pose a problem. Judgment will be made by comprehensively taking matters such as the character of research, need for collaboration, and range of objectives into consideration.
- Even where the collaborative undertaking of R&D presents no problem of its own under the AML, arrangements accompanying its actual implementation may affect competition in the product market, thereby creating problems under the AML. These problems may occur (a) if an arrangement unjustly restricts the business activities of a participating firm, thereby impeding fair competition, and (b) if competitive business activities relating to the price and quantity of a product are mutually restricted among participating firms. Thus, collaborative R&D presents a problem under the AML if there is a spillover of anticompetitive practices from the precompetitive R&D stage to the stage of product market competition.
- In principle, under the AML, participants in collaborative R&D can be required (a) to disclose information on technologies necessary for

the collaborative R&D project, (b) to report to other participants on the progress of their share of the research work, and (c) to keep secret the information on technologies disclosed to them by other participants in connection with the collaborative R&D.

- In principle, it does not present any problem under the AML (a) to restrict, within a reasonable period, the marketing of products utilizing a technology that is the fruit of the collaborative R&D project to the participants or a designated firm or firms, if it is deemed necessary to maintain the secrecy of the resulting know-how; or (b) to restrict, within a reasonable time, the source(s) of supply of raw materials or parts for products utilizing the technology resulting from the collaborative R&D project to other participants or to a designated firm or firms to maintain the secrecy of the resulting know-how and ensure the quality of products based on such technology.
- Other restrictions, even those based on the propriety of one's collaboratively developed technology, such as (a) restrictions on the production or on the territory where the product may be sold, or (b) restrictions on the production or on the volume of sales of the product, may fall into the category of unfair trade practices.
- To supplement these guidelines, a prior-consultation system has been established whereby any uncertainty about whether a specific collaborative R&D project presents any problems under the AML may be resolved. The party eligible to request prior consultation is the firm or the trade association intending to implement the collaborative R&D, irrespective of whether the firm or the trade association is domestic or foreign.

It is worth noting that the JFTC Guidelines were published for the purpose of facilitating procompetitive collaborative R&D by making the legal constraints on such associations more transparent. Recently, and in a similar spirit, both in the United States and Europe, the antitrust laws and their practical implementation have become clearly more lenient in regard to collaborative R&D with the passage of the National Cooperative Research Act in 1984, and the Block Exemption from Article 85 in the European Community for some categories of R&D agreements in 1985. It is against this background that the following observations on the JFTC Guidelines may be of some relevance.

The first observation is a general one which pertains not only to the JFTC Guidelines on collaborative R&D but to competition policy in general. Although the preliminary analyses laid out earlier in this chapter cast doubts on the universal validity of the common belief in the welfare-improving effects of increased competitiveness, this conventional wisdom seems to persist in the JFTC Guidelines in that collaborative R&D is judged to present no problem under the AML only when it is pro-

competitive. It seems that the crucial criterion for approving any coordinating device should be whether or not it leads to an improvement in social welfare; to be procompetitive is neither necessary nor sufficient for this crucial criterion to be satisfied.

The second observation pertains to the second guideline. According to this guideline, horizontal R&D collaboration among competing firms and vertical R&D collaboration among noncompeting firms have strongly contrasting implications in that the former, but not the latter, has a non-trivial likelihood of posing problems under the AML. However, it seems that R&D collaboration among vertically related firms—say, a ceramics manufacturer and an automobile manufacturer for the development of a ceramic engine—if successful, may have a serious impact on competitiveness in both the ceramics industry and the automobile industry. In general, the overly sharp demarcation between horizontal and vertical R&D collaborations does not seem to be warranted.

The third observation pertains to the markets whose competitiveness is the focus of the JFTC Guidelines in judging whether or not R&D collaboration presents problems under the AML. One may easily verify that domestic markets are exclusively focused upon in this context, even though the first and last guidelines assert that foreign firms are to be treated on a par with domestic firms. Thus, the effects of the participation of foreign firms in Japanese collaborative R&D on the competitiveness of foreign markets play no role whatsoever in the JFTC judgment on the pro- or anticompetitiveness of R&D collaborations. This insidious feature of the JFTC Guidelines may be in need of further examination from the viewpoint of international harmonization of antimonopoly legislation and its implementation.

Concluding Remarks

This chapter presents a brief overview of formal as well as informal policy measures for controlling competition in Japan, starting with the formal systems of exemption from the Antimonopoly Law and proceeding to informal policy measures—such as administrative guidance—that have been invoked by government ministries in pursuit of industrial policy objectives. In the following paragraphs, I summarize the main points of this chapter.

A rational answer to the crucial question of whether there is any room for justifiable interference in free market competition hinges on the objective function involved. If one measures the performance of market competition in terms of consumers' surplus (or producers' surplus), entry regulation does not improve (or does improve) market performance at the margin for a wide class of economies. If one is prepared to add consumers' surplus and producers' surplus to define net market surplus

as a performance criterion, then one is led to conclude that entry regulation improves market performance at the margin. The same conclusions are valid for regulation of R&D investment at the margin as well.

According to the AML, a private monopolization or cartel is unlawful if and only if it restricts competition contrary to the public interest. The crucial term—public interest—admits several alternative interpretations, and the choice made among them dictates the rigor with which the AML is applied to a private monopolization or cartel. I have identified three interpretations, adopted by the JFTC, the Federation of Economic Organizations, and the Supreme Court, respectively, which roughly correspond to the three performance criteria mentioned above, that is, consumers' surplus, producers' surplus, and net market surplus, with their respective welfare implications.

The systems of exemption from the AML are both extensive and complicated, but the number of cartels under these systems has been decreasing, and some of the exempted cartel systems have been dormant for a long time. There are also several exempting laws of historical importance, as typified by the Law on Temporary Measures for Structural Improvement of Specified Industries, the Law on Special Measures for the Promotion of the Machinery Industry, and the Law on Special Measures for the Promotion of the Electronics Industry. However, all these laws of historical importance had ceased to be effective by June 1988, and in some cases much earlier.

Even if the systems of exemption from the AML and other provisions for controlling competition are formally straightforward, the actual implementation of the anticompetition policies may become extremely complicated as well as opaque through informal administrative guidance and bureaucratic conventions. This was illustrated by two case studies: entry regulation in the retail industry and telecommunications reform in 1985. In this context, the newly enacted Administrative Procedure Law, which clarified the lawful limit of and legitimate procedure for administrative guidance, is crucially important.

Collaborative R&D among otherwise competitive firms is often believed to generate welfare-improving effects, and there are proponents who ask for more lenient AML applications to this class of collaborative activities. I have identified positive as well as negative implications of collaborative R&D and critically examined the rationale of the AML Guidelines Concerning Joint Research and Development.

Postscript: June 1997

Japan's AML and competition policy are currently in a state of flux. In June 1997, the original prohibition of pure stock-holding companies was lifted, and in 1999, the exemption of depression and rationalization

cartels from the AML is scheduled to end. Despite these substantial changes in competition policy, the main message of our chapter stands without revision.

Japan's telecommunications policy is also radically changing. MPT and NTT came to an historic agreement in December 1996 concerning the plan to split NTT into a long-distance company, two local companies, and a pure stock-holding company that would control these operating companies. This plan was formally implemented by the June 1997 NTT Company Law. Triggered by this radical change in the managerial form of NTT and by concomitant deregulation, the telecommunications business, domestic as well as international, is now subject to a wave of new entries and strategic alliances that are leading toward more competition. Events leading up to the developments summarized in this postscript are described in detail in Suzumura (forthcoming).

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